No. 22—September-October 1958

Business in Brief

issued bi-monthly by the Economic Research Department

THE CHASE MANHATTAN BANK

The pace of business recovery from the April low has exceeded expectations. Industrial production has come back 9% in four months, thus recouping more than half the decline in the preceding eight months.

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The upturn in activity is a result of two broad developments:

¶ The downward pressures imposed by inventory liquidation and by the decline in business fixed investment have eased;

¶ Expenditures by consumers and governments have increased, adding to the over-all demand for goods and services.

Recent signs point to a continuation of the recovery. Manufacturers' new orders topped shipments in July. In the critical machinery area, new orders have shown a definite uptrend in recent months. New housing starts are nearing a 1.2 million annual rate.

Consumer markets are also displaying increasing strength. Department store sales are now running 3% ahead of a year ago. Total retail sales have almost regained last year's peak, despite the lag in autos.

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News of these favorable developments has generated expectations of a rapid return to capacity production, high-level employment and inflationary pressures. Prospects of a continued deficit in the Federal budget have reinforced these views. Fear of inflation has undoubtedly been an important factor in recent trends in stock and bond markets.

It is, however, far from clear that such expectations will be validated in the near future. For one thing, the pace of advance in industrial production may slow somewhat. The impetus furnished by the shift to normal buying for inventories could begin to wane before long.

Consumer markets, while basically strong, are far from exuberant. People are still buying carefully and are reported to be extremely price conscious. Likewise, looking to the future, most estimates today are that sales of the 1959 autos may run to 5½ million – a good year, but far from a banner one.

Moreover, the economy has considerable excess productive capacity while unemployment amounts to some 7½% of the labor force. Thus production can be expanded rapidly as demand rises. With a normal growth in productivity, a 10% rise in GNP in the year ahead would be required to fully utilize our resources. In contrast, the average annual growth in GNP for the past decade works out to less than 4% in constant dollars.

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Excess capacity is still placing a drag on business investment in new plant and equipment. Expenditures have dropped almost $7½ billion, or one-fifth, in the past year. However, the latest SEC-Commerce survey points to a 2½% increase in the fourth quarter, marking the end of the decline.

A strong upturn in business fixed investment is a necessary condition for continued vigorous recovery. Can such an upturn take place in face of excess capacity?

New estimates by Fortune magazine place the 1957 gap between production and capacity in manufacturing at 6%. Thus most of today's idle capacity is due to the recession, rather than to a basic over-building. And the revival in demand could lead to renewed expansion next year, though at a lower rate than in 1955-57.

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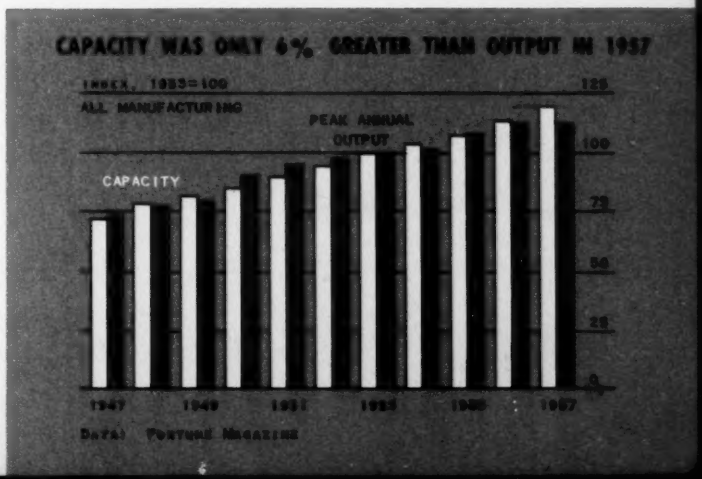
A sustained upturn in business investment next year combined with a continued improvement in consumer markets could lift economic activity to full-capacity levels, perhaps by late 1959. Thus, the problem of containing inflationary pressures could become increasingly important as we move through 1959.



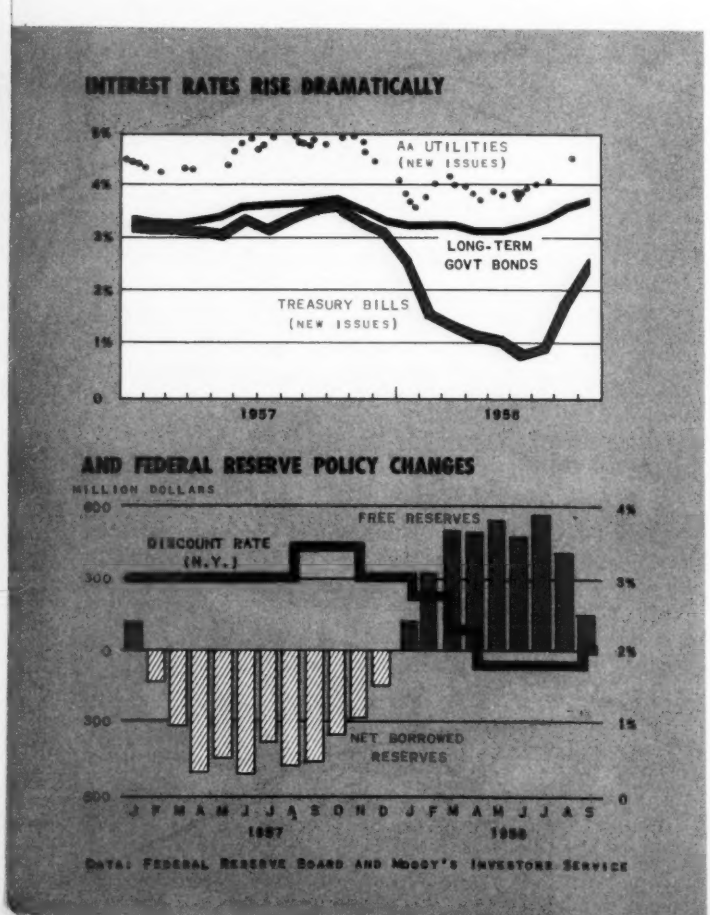
TURBULENCE IN THE MONEY MARKETS

Seldom in American financial history have interest rates climbed so rapidly as they did during the summer of 1958. In the space of three months, prices of some longer-term Government bonds fell by 8 to 12 points, equivalent to a rise in yields of roughly ½%. In the corporate market, rates as high as 4% or 4¼% were needed in September to attract funds into new high-grade issues; whereas in early June prime borrowers had been able to obtain money at 3⅞% or less.

The sharply rising rate structure and disturbed market conditions have induced some postponements of proposed financings. And there are now clear signs that new mortgage money also has become more costly.

Paradoxically, these dramatic shifts in the climate of the capital markets got underway in the midst of the recession, and well in advance of recent Federal Reserve moves away from a policy of "active ease." Moreover, demands for long-term funds, while remaining active, did not increase. Clearly, the sharp and sudden increases in longer-term interest rates must be explained partly by a shift of market psychology. In recent weeks, that shift in sentiment has been supported by the rapid business recovery and a change in Federal Reserve policy.

In retrospect, it seems apparent that the seeds of a swift reaction were laid partly in a growing volume of speculation in the Government bond market during the first half of 1958—a degree of speculation not readily apparent to those participating in the market. During the first half, corporations, state and local governments, and the United States Treasury offered intermediate and long-term securities in unprecedented volume. Nevertheless, bond prices, after a precipitous rise in late 1957, continued to trend upwards, at least through April.



A Reversal of Expectations

The buoyancy of the market through that period of heavy demand can be traced partly to firm expectations that, with credit policy continuing to ease and with business activity still contracting, the upward price trend would persist for some time. Thus, many essentially short-term investors were encouraged to lengthen portfolios in an attempt to maintain income. And others, without any lasting interest in the market, aggressively bought bonds on the basis of borrowed money with the thought that temporary commitments could shortly be liquidated at a profit.

Speculation of that sort reached a climax during the Treasury's June refunding. Of the $9.1 billion maturing issues held by the public, $7.0 billion were exchanged for the longer (and higher-yielding) of the two issues offered in exchange, the 2½s of 1965. That total was far greater than the market had anticipated. Moreover, in the eventual market reaction it became clear that many of the bonds had been financed on thin margins, or had been acquired by investors interested in holding them for only a short period.

At that critical juncture, a number of factors helped to shake the confidence of the market in further price advances.

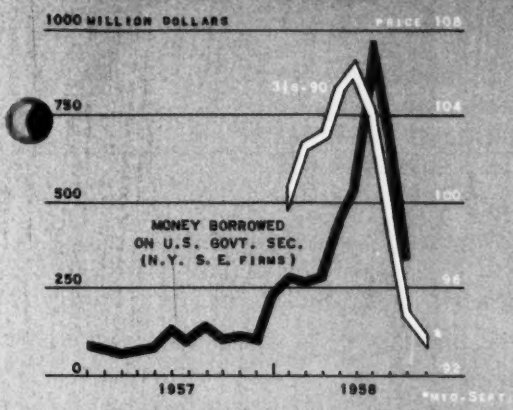
- Estimates of the prospective Treasury deficit for the fiscal year 1959 had mounted to $10-12 billion. Doubts concerning the Treasury's ability to finance a deficit of that magnitude at prevailing interest rates, and without an inflationary expansion of bank credit, became widespread.

- Earlier expectations that the volume of corporate financing would diminish sharply during the course of the year began to fade, as new offerings continued to reach the market in heavy volume. In addition, several corporations announced plans for large new issues in coming months.

- While no concrete evidence of a shift in credit policy was yet apparent, reports began to circulate that the Federal Reserve might act soon to reduce the prevailing ease in the money markets.

- Perhaps most basic of all, some signs appeared that the low point of the recession had been reached. A growing conviction on the part of many investors that inflationary pressures would soon reassert themselves was implicit in the steady rise in stock prices through the spring.

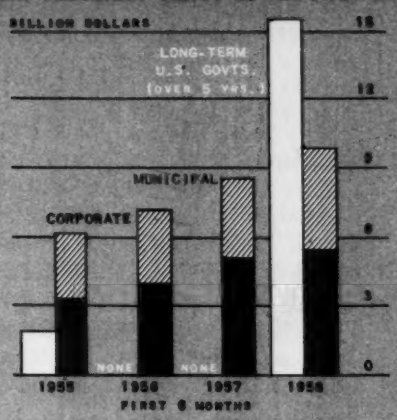
BORROWINGS ON U.S. GOVERNMENTS RISE SHARPLY THEN DROP



DATA: TREASURY DEPARTMENT AND N.Y. STOCK EXCHANGE

A rapid increase in borrowings against Government securities by Stock Exchange firms through June, while accounting for only a fraction of the credit used to finance purchases of bonds, dramatically reflects the buildup of a speculative psychology in the market over the first half of 1958.

NEW BOND OFFERINGS WERE UNUSUALLY HEAVY IN THE FIRST HALF



DATA: TREASURY DEPARTMENT AND S.E.C.

In such a setting, the psychology of the bond market deteriorated rapidly once some of the temporary holders of Government issues began to lighten their commitments. So strong were the selling pressures in late June and July that the Federal Reserve and the Treasury found it necessary to undertake large purchases of Government securities in order to maintain a semblance of order in the market.

By September some signs appeared that a degree of stability might be returning to the market. But by that time rates for longer securities had already reached levels close to their post-war highs of last year.

Federal Reserve Abandons "Active Ease"

Not until August, fully six weeks after bond prices began their steep decline, did the Federal Reserve take overt action to move to a policy of less easy money. In succeeding weeks, with signs multiplying that a strong business recovery was indeed underway, the monetary authorities quickly placed themselves in a position to reimpose restraint on the lending power of commercial banks.

Through July, member bank free reserves were maintained at a level of $450-700 million. That range had prevailed since March of this year, and was indicative of Federal Reserve efforts to promote a ready availability of bank credit as an aid to business recovery.

By the first half of September, in contrast, free reserves averaged only $125 million. Member banks, particularly in the major financial centers, increasingly found it necessary to borrow from the Federal Reserve in order to maintain their reserves at required levels. Concurrently, the Federal Reserve banks, beginning on August 15, made such borrowings more costly by increasing discount rates from 1½ to 2%. That action unambiguously signaled the end of aggressive ease.

These measures of the Federal Reserve were promptly reflected in a sharp rise in short-term interest rates from the depressed levels reached during the phase of easy money. Three-month Treasury bills, for instance, traded at 2.3-2.5% during the first half of September, as compared with 1% or less during July. And the principal commercial banks soon raised their prime lending rate from 3½ to 4%.

Conclusion

Neither the current level of free reserves nor a discount rate of 2% imply that the Federal Reserve, at this point, wishes to reimpose severe restraints on the availability of bank credit. On the other hand, the monetary authorities apparently no longer feel it necessary to foster credit ease as an aid to recovery. In this regard, Federal Reserve officials have frequently expressed serious concern over the longer-run inflationary pressures in the economy, and they have suggested that they erred in not tightening credit more promptly in the early stages of the last boom.

The initial vigor of the business recovery, coupled with the speedy Federal Reserve action, have to some extent tended to bear out the shift in expectations responsible for the sudden rise in long-term interest rates. Nevertheless, the tumult in the bond market over recent months has disquieting implications. Fluctuations in long-term interest rates have been exaggerated, as perhaps never before, by the activities of speculative interests subject to capricious and extraneous influences. Substantial new risks and uncertainties were created for dealers, investors, and borrowers—including the U. S. Treasury. Normal trading activity has been inhibited for an extended period of time, and the Federal Reserve itself apparently found its freedom of action seriously circumscribed for some weeks.

The pursuit of effective monetary policies in this country depends upon the existence of a reasonably broad market in Government securities, responsive primarily to fundamental shifts in the liquidity of the economy, but free from prolonged periods of acute instability related to purely speculative considerations. Recently these standards have not been fully met. Those concerned with credit and debt management policies, and the market mechanism essential to them, may have a common interest in reexamining current procedures and practices.

ELECTRIC POWER

America has been called a push-button economy—and the phenomenal growth of the electric power industry clearly bears this out. In the past eight years alone, production of electric power has more than doubled. What's more, the industry has proven to be much less vulnerable to recession than business in general: power output has increased in every year during the postwar era in spite of three moderate adjustments in over-all activity.

What lies behind this remarkable record? In a very basic sense, the growth of power is both a cause and effect of the dynamic expansion of our economy.

Industrial Use

This year it is estimated that well over 600 billion kilowatt hours of electrical energy will be produced. A primary user of this power is industry—the manufacturers and processors—who currently consume about 45% of total output. This ratio has been fairly stable during the postwar years.

Industry's mounting reliance on electricity is a key feature of our business environment, for power is the propelling force in advancing productivity. For example, it has been estimated that the energy an average working man exerts in a year is equivalent to about 67 kilowatt hours of electricity. But to supplement his efforts he now has the equivalent of 290 fellow-workers in the form of electrical machinery and equipment. Thirty years ago, with power less plentiful, his electrical helpers numbered about 70.

Residential Use

The other major consumers of electric power (and the largest contributors to total revenues) are the households of America. Projections of residential electric consumption have been continually revised upward as the widespread ownership of automatic washers, dryers, air conditioners and the like have brought an electrical revolution to the home.

Most families never stop to measure the power they employ. Few of them realize that an electric razor takes but one kwh a year; a vacuum cleaner 29; a television set 297. It is probable that owners of air conditioners know that such aids to better living require about 1,000 kwh on the average. However, it is safe to say that power consumption seldom is the factor limiting the use of appliances. At any rate, average home consumption today is over 3,000 kwh yearly—a rate that has doubled in the last ten years.

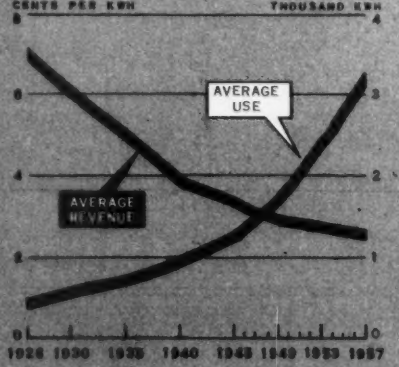
Use Up, Rates Down

The pricing record of the electric utilities is also an impressive one. As the use of electricity has soared, the average rates paid per kwh have steadily fallen: thirty years ago a residential consumer paid almost three times as much per kwh as he now pays. Electricity is more than ever a bargain. In recent years, many utilities have been forced to increase rate schedules because of mounting costs. The consumer's average charge, however, has continued to fall, for rate schedules generally decline as usage expands—and the added consumption of power in the home has brought these economies to most households.

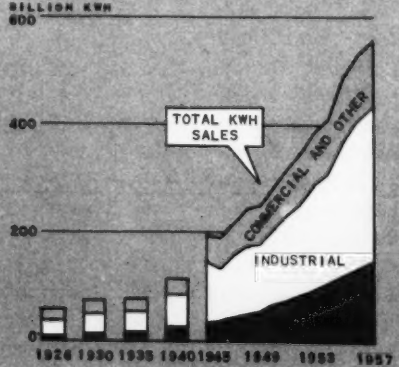
To maintain and extend its record of furnishing power at minimum rates, the electric utilities have consistently sought to utilize the most modern facilities. Year after year their expenditures on new equipment play an important role in the over-all construction outlook; it takes $4 of investment to produce $1 of revenue from electric power. In 1958 the electric utilities are expected to account for almost one-seventh of total outlays for new plant and equipment.

The financing of these new plants has posed a major problem for the utilities. Well over $20 billion has been required since 1950. To raise these funds the privately-owned electric power companies sold $9.2 billion of bonds, $1.6 billion of preferred stock and $3.0 billion of common stock. The rest came from reinvested earn-

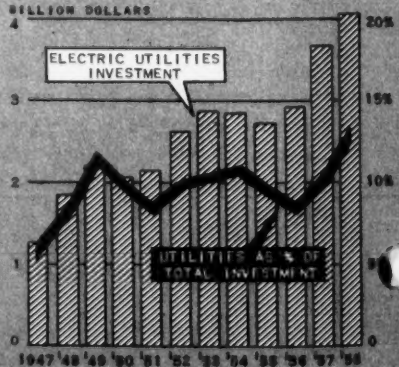
THE RESIDENTIAL PICTURE: USE UP, COST PER KWH DOWN



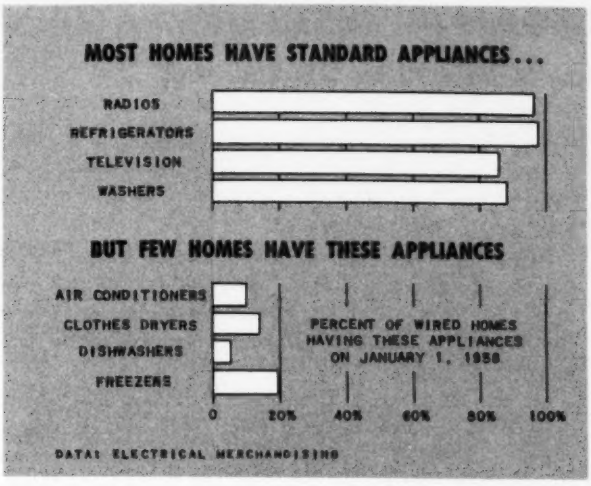
POWER OUTPUT HAS DOUBLED EVERY DECADE



$28 BILLION HAS BEEN INVESTED IN THE PAST DECADE



DATA: EDISON ELECTRIC INSTITUTE AND S.E.C.



ings. Fully one-fifth of all the security offerings made during the postwar period have emanated from the electric utilities.

One result of heavy capital investment outlays has been a steady improvement in efficiency. In terms of the amount of coal required to produce one kwh of power (and coal is by far the most important source of energy, accounting for 56% of the total), the figure has declined steadily—from over 2 pounds in 1925 to less than 1 pound today. And with the continued trend towards higher temperatures and pressures, further improvements are anticipated. In addition, development of nuclear power is proceeding.

Changing Seasonal Patterns

Another long-term development is the increase in the "load factor"—the average utilization of capacity throughout the course of the year. Electric utilities must maintain a capability to meet peak loads. In former times this meant that capacity would be utilized to its maximum during the winter months, when plants were in full operation and weather and lighting conditions required large amounts of power. Then, the summer meant a substantial decline in power use.

Now, however, the seasonal pattern of electricity consumption seems to be leveling out. The summer months are among the busiest for many of the utilities—chiefly because of the widespread use of air conditioners. Sales of room units have risen sharply in recent years and are currently at a 1.6 million rate.

Future Prospects

It is when we look at prospects for future electrical use that the dynamic elements of the industry truly emerge. As a rough rule of thumb, electric power output has doubled about every ten years since the early 1900's. And projections of the Federal Power Commission show that by 1980 power use in the U. S. could be approximately three times the present levels.

- The homes of our nation offer the greatest potential markets. A fully electrified house (including a heat pump) uses about 25,000 kwh per year—almost 8 times the national average. With increased population, higher incomes and new technological developments, the market for added electrical use would seem to be vast.

- Industry, too, has been steadily finding new uses for electricity. Developments in electrometallurgical processes, ultrasonics, and the increased trend toward automation spell new horizons for power. And, incidentally, power is generally only a minor element in production costs—averaging but 2% of the total for manufacturing.

Thus the electrical power industry may be counted upon to continue to reflect and augment the rising trend of the economy.

THE HEAT PUMP

The trend toward "making your own climate" should point to increased demand for electricity. Air conditioners have already proven a boon to the electric utilities by increasing sales and helping to smooth out their strong seasonal pattern. And the latest development in this field is the heat pump — an all-in-one heating, cooling, filtering, dehumidifying system which takes the place of both a furnace and an air conditioner.

The heat pump works on the same principle as a refrigerator; in fact, a refrigerator is a one-way heat pump. Unlike furnaces, the pump does not create warmth, rather it moves heat via a refrigerant and a compressor out of the house in summer and into the house in winter.

At the start of 1958, 23,500 heat pumps had been installed. This is more than ten times as many as were operating in 1955 and almost double the number in use last year. So far the majority of these are in the South. But as technological improvements increase their efficiency, their use is becoming more widespread.

How much does a heat pump cost? At present the price runs about 15 to 20% more than conventional heating and air conditioning equipment — from $2,500 to $3,000 for a house in the $15,000-20,000 price range. Operating costs depend on the climate and the exact rates charged for electricity.

If the heat pump should gain general acceptance, the potential increase in sales of electricity would be substantial. It is estimated that installation of a heat pump in the average home would cause consumption of electricity to shoot up from 3,000 kwh to about 20,000 kwh.

THE WESTERN EUROPEAN RECESSION

Does It Reflect The U.S. Downturn? How Might It Affect U.S. Recovery?

As the U.S. economy has been regaining momentum there has been growing concern over the business situation in Western Europe. Since last fall, industrial production has leveled out in the U.K., West Germany and Italy. Only in France has industry moved ahead. But the general picture is one of a moderate slackening.

Western Europe and the U.S. are tied together economically through trade, private investment and various aid programs. Trade is by far the most active link – one-fourth of our trade is with these nations while about one-seventh of their trade is with the U.S.

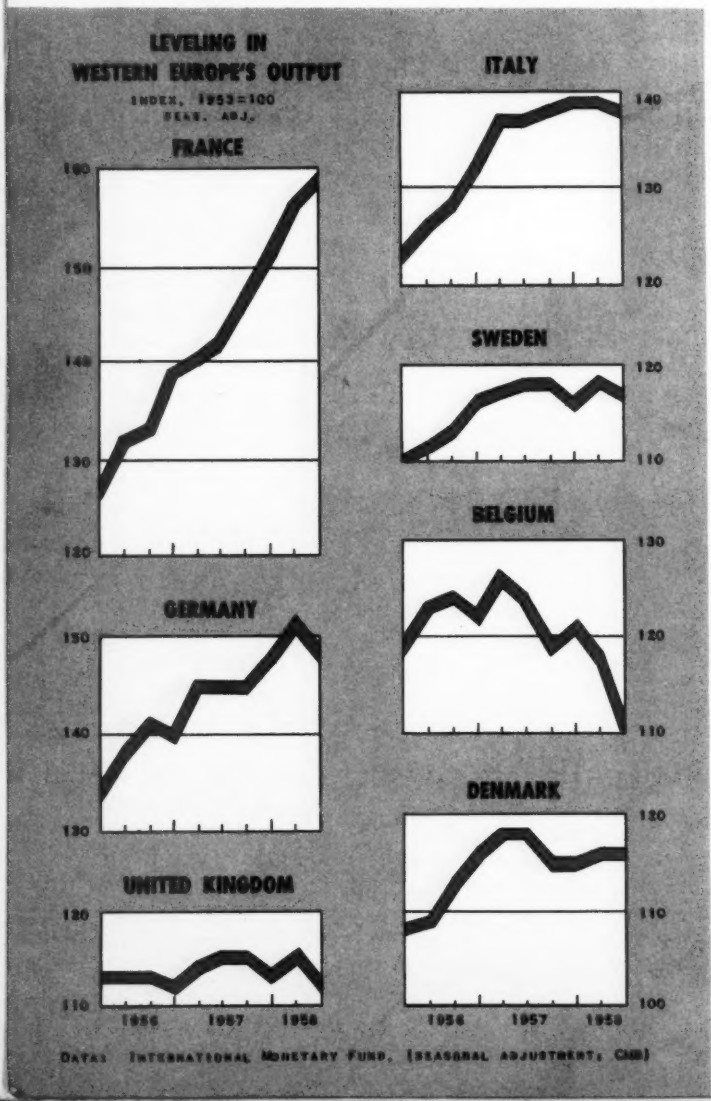
Trade Trends

The principal way in which the U.S. recession might affect Europe is through a reduction in our imports – this would reduce their dollar earnings. Actually, our imports from Western Europe have fallen less than 1% during the past year. We bought 7% *more* from the U.K. in this period – mostly in the form of larger imports of British autos and aircraft. U.S. imports of British autos have almost doubled this year.

In addition, the outflow of U.S. capital to the rest of the world, including Europe, may be greater this year than last. This is a noteworthy phenomenon, in view of the decline of one-fifth in capital investment by U.S. business at home.

On the other hand, U.S. exports to Western Europe dropped 27% during the past year. Thus, the decline in Western Europe's purchases in the U.S. has been far greater than that in our imports from Europe. Few observers expected that the U.S. might be more sensitive to a downturn in the European economy than Europe is to a U.S. recession.

The explanation lies in the composition of trade. The U.S. exports mainly cotton, coal, steel and machinery – items whose purchase would be affected by a mild slowdown in over-all European demand. U.S. imports from Europe consist mainly of consumer products – textiles, food, china, furniture and autos, for example. Except for autos, which are a special case, a moderate recession in the U.S. has little effect on demand for such products.



Europe's Prospects

The question now is what may happen in the period ahead. A continued decline in the European economy could have a dampening effect on U.S. exports, both directly and in terms of its impact on the less developed nations. A renewed advance in Europe would stimulate demand for exports in the U.S. as well as in other nations.

At least to date, Western Europe's period of economic adjustment seems to reflect the same sort of influences that have been at work in the U.S., though on a more moderate scale. The expansion of capacity in recent years outran demand and led to the need for a period of consolidation. Thus, the major impact so far has been a decrease in production and inventories in metals and metals-using lines.

Basic demand for consumer durables is exceedingly strong in Western Europe – auto sales in the U.K. rose this year. Opportunities to increase productivity by increased capital investment are most attractive. And monetary and fiscal policies in many nations are being used in a manner that could exert substantial leverage in the direction of renewed growth.

Thus, there would appear to be room for hope that the Western European economy would begin to move forward again before too long. This could provide an additional impetus to U.S. recovery and to the expansion of the entire free world economy.

NATIONAL WEALTH

The nation's tangible wealth reached the impressive total of $1½ trillion at the end of 1957. Tangible wealth consists of the depreciated value of all housing, consumer durables, buildings, machinery and land in existence. Last year's total was nearly 3½ times the annual production of all goods and services, and 11 times the production of durable goods and construction.

Why is it important to consider the state of the nation's wealth? Usually we look at total annual production and its growth. Yet measures of wealth can be valuable in many ways.

Wealth has been defined as "a picture of past events which are still economically relevant." This is one cue to its usefulness. It gives us a sense of economic perspective, as well as a measure of utility that is stored up for future consumption.

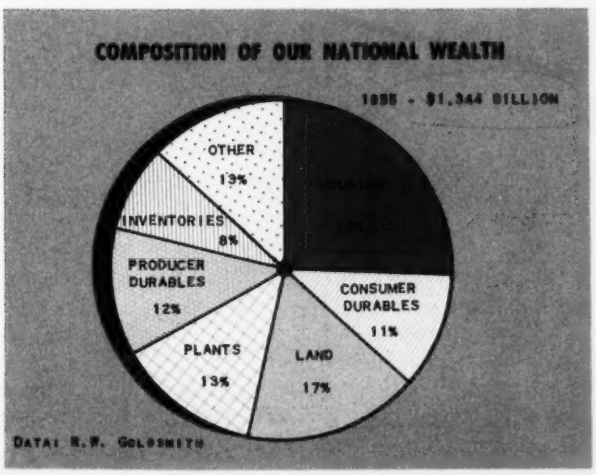
Growth of Wealth

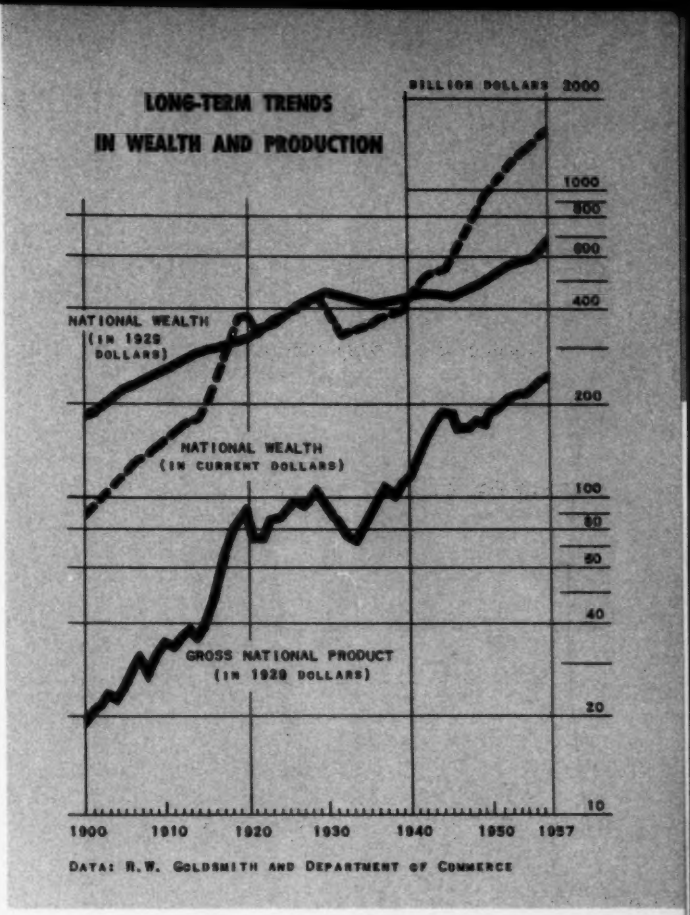
With the sole exception of the early 1930's, wealth has grown steadily throughout our history. Few other nations have witnessed such a consistent record of dynamic growth.

In the century and a half 1805-1956, wealth increased at an average rate of 4% per annum (measured in constant prices). In the same period, output rose at an average rate of slightly more than 3%. The increase in wealth during the most recent decade was well in line with the long-term average.

Wealth and Productivity

The growth in our wealth – and particularly in that part consisting of plant and equipment – supports the increase in productivity. We have been able to increase output per man-hour over the decades, not by working harder, but by supplementing human effort with more powerful and more productive capital goods.





Thus, our growth in real wealth per capita has averaged 2% per annum for 150 years. Production per person – productivity – has also increased 2% per annum. Interestingly enough, our stock of capital is roughly twice that of Western Europe and output per man-hour in the U.S. is double that in Western Europe.

These facts underline the importance of steps to encourage the accumulation of tangible wealth. However, a balance must be maintained – if plant and equipment accumulates too rapidly, as it may have done in 1956 and 1957, excess capacity can develop.

Meaning of Wealth

A nation's wealth is one measure of its well-being. Wealth in the form of homes, public assets, automobiles, and other consumer durable goods is a manifestation of a high standard of living. Expanding stocks of plant and equipment are necessary to support an improving standard of living.

However, the ultimate measure of any society is not its ability to amass wealth. It is, rather, the society's ability to use its wealth and its productivity constructively. In our society the ultimate goal is the well-being of the individual. Thus, we must be constantly concerned that our growing wealth reflects objectives that contribute to the fullest development of all of our citizens.

Why don't you talk to the people at Chase Manhattan?

"Sure our sales territory is much larger now but decentralization locks up our funds for too long a period, and I certainly would like to get the money in faster. It's like a log jam."

"We had the same experience until one of the Chase Manhattan specialists solved the problem for us in a sensible way. Why don't you talk over your situation with them."

* * *

Costly delays in transferring funds to the place where they are needed can easily be avoided. The Chase Manhattan Money Mobilization Department has developed certain techniques for making money move in the fastest possible time. You, too, may find that a plan tailored to your requirements is the best way to get the most mileage out of your sales dollar.

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